

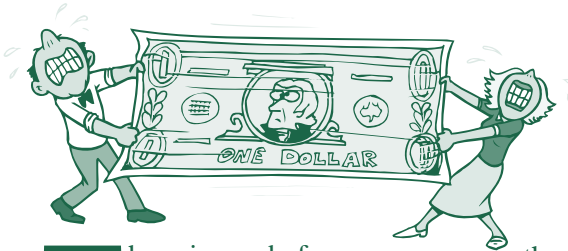
Brief



April 2001

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Payday and Sale Leaseback Loans



Those in need of emergency cash but without good banking relationships or credit cards can turn to a quick and convenient finance company. There, depending on the preferred terms—“deferred deposit,” “check advance loan,” or “dated check loan”—a small loan, for a small amount of cash, for a short time, for a certain fee, can be obtained. These payday loans, if you are employed, can get you needed cash for a short period of time before your next paycheck.

If the amount of the loan is between \$100 and \$400, with a loan period from between 7 to 14 days, interest rates can drive fees as high as \$33 per \$100 borrowed, or higher. The explosive growth of payday advances is recent, and according to a 1999 Illinois Department of Financial Institutions report, the number of U.S. payday-loan stores doubled to 6,000 in the nineties, with predictions that the industry will grow 600 percent in

the next decade. In Texas, according to data from the Texas Office of Consumer Credit Commissioner (OCCC), small loans grew from just over 1.5 million in 1985 to 2.5 million in 1990. In the three years between 1992 and 1995, the number of loans from finance companies increased by 24 percent. By contrast, the state’s population increased only 10.2 percent between 1990 and 1995. “The finance companies are picking up the slack left from the savings and loans,” says Arthur B. Kennickell, an economist for the Federal Reserve Bank. “It is part of the continuing restructuring of the industry.” With this growth comes some debate.

Are payday-loan operators niche lenders focusing on a market ignored by everyone else, as stated in an editorial in the *Chicago Tribune* last year? Proponents say that comparing the payday loan to a typical loan borrowed over a 12-month/365-day period is illogical because the annual

“Small debts
are like
small
shot;
they are
rattling
on every
side, and
can scarcely
(sic) be
escaped
without a
wound.”

—Samuel Johnson



FICTION OR FACT?

They prey on those rushed for cash—often because of an emergency.

—Express-News

Data in Illinois and California indicate payday borrowers have an income of \$23,000 to \$25,000.

—State Government News

According to a 1992 national survey sponsored by the Federal Reserve, finance company customers are generally younger, less likely to be white, and more financially insecure than their bank-borrowing counterparts.

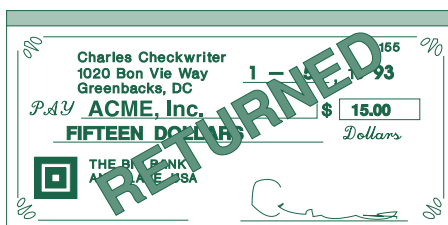
Consumers are charged outrageous rates.

—Consumers Union

Service fees to payday consumers are less costly than the alternatives: bounced check fees, late payment fees, and tarnished credit ratings.

—State Government News

percentage rate, or APR, is a yearly calculation, while most payday loans are for a shorter period. The Community Financial Services Association (CFSA), a group of payday cash operators, contends it is unfair to compare short-and long-term interest rates. Other fixed fees, such as a \$1.50 fee on a \$100 ATM transaction, would be 547.5 percent APR and a \$22 Non-Sufficient Funds bounced check fee on a \$100 check would be 8,030 percent APR, CFSA points out. And while the same Illinois report claims payday advance fees are “exorbitant,” others argue not when compared to increases in banking fees across the country. Payday lenders purport their loans cost more because many operators write off their bad debt, rather than pursuing criminal or civil recourse. A consumer services representative in Washington state weighs in by arguing that while payday loan businesses charge a lot of money for a loan, complaints are few because consumers understand what they are doing and are doing it willingly for the service given.



But problems with repayment can change the picture. When the loan customer cannot repay the loan, the loan is rolled over. If a pattern is established, with renewal of the loan continuing, each time larger fees are incurred (loans can be renewed up to 11 times) the interest grows exponentially. That first check to cover that first loan, with a small fee, grows considerably with each rollover, and



A little SHORT this month?

if writing checks with insufficient funds, the resolution of the matter can end up in the criminal courts.

Another controversial practice related to payday lending is sale-leaseback lending. This practice lacks many of the rules and regulations because the borrower keeps the collateral, a microwave, for example, to be “sold” to a storefront lender, then “leased” back until paid. Or a \$300 television that garnered the borrower a quick \$200 might cost five times that, if the borrower cannot repay the loan. Because this transaction is considered a lease, not a loan, the transaction escapes regulatory attention. Where does this leave Texas lawmakers?

During the interim of the 76th Legislature, a number of recommendations from both the Sunset Advisory Commission and the Senate Economic Development Committee were made regarding payday loan and sale-leaseback transactions. The House Committee on Financial Institutions



recommended that small consumer loans, or payday loans, be subject to licensure and regulation; however, in the matter of sale-leaseback transactions, there was no recommendation. The Senate Economic Development Committee and the Sunset Advisory Commission called for a new law to broaden the definition of a loan to include sale-leaseback agreements.

The OCCC, in the absence of legislative action during the last session, licensed payday lenders, capped fees at \$10 up-front, with interest at 4 percent per month, and limited rollovers, or renewals, to one every 30 days. After the second renewal, the lenders were ordered to convert the loans into declining balance loans and borrowers given repayment schedules.

In spite of the OCCC's regulations, a newly released study by the Consumers Union (CU) indicates that payday loan regulations are being flaunted in Texas. According to CU, the real erosion of the interest-rate cap came with the deregulation of the banking industry. Federally chartered banks cross state lines, and a few out-of-state banks offer payday loans through their Texas agents, charging interest rates without any caps and allowing their "agents" to offer loans that are less than consumer-friendly. The OCCC says there are other ways to "put a certain façade on the practice" in the state, including the sale-leaseback arrangement, and the office has experienced an increase in the number of com-

plaints about these loans, adding to the criticism of both payday and sale-leaseback loans.

An early amendment to the Texas Constitution in 1891 sought to limit usury by capping interest rates at 10 percent in response to credit abuses. While the cap is still in force, other developments have eroded its protection. Until a few years ago, Texas limited "sub-prime" lending to unsecured signature loans and pawns at annual percentage rates approaching 90 percent. Pawns and unsecured signature loans were legalized because legislators believed there was a need for these small, short-term loans.

During the 77th Legislature, the following legislation has been proposed to address these lending practices:

Senator Sibley authored S.B. 317 (companion H.B. 1816/McCall), which continues the functions of the OCCC until the year 2013 and

amends Section 8 of the Finance Code to define "deferred presentment transaction" (payday loans). The amended language authorizes the finance commission to adopt rules regulating these loans and provides that a person who is a party to a deferred presentment transaction may not evade the laws or rules adopted regarding deferred presentment transactions. Other stipulations in the bill include renewal terms and the requirement that the form of the loan contract be written in plain language whether in English or Spanish.

Senator Carona's S.B. 471 and its companion, H.B. 1366 by Representative Solomons, designate the OCCC to continue to regulate payday loans and provide safeguards for consumers who seek them. The bills would cap the loan amount at \$500 and set a \$15 limit for every \$100 advanced.

All 50 states have existing regulations in some form, but the increasing popularity of this market and consumer complaints have led to an increased awareness. Texas joins more than 12 other states addressing the issue this session, including Alabama, California, Florida, Georgia, Hawaii, Illinois, Indiana, Maryland, Michigan, North Carolina, Oklahoma, and Virginia. A recent segment aired on Jim Lehrer's broadcast on PBS featured the national popularity of payday loans, with many of the same issues that are prominent in Texas.



The OCCC says national banks have followed the lead of companies that issue credit cards and do business in one place to avoid rules and regulations in another. Three banks from Nevada, South Dakota, and Utah have set up operations in Texas to handle payday loans and evade usury laws.

Consumers Union found fringe/finance lenders located in areas where predominantly young, non-white, and low-to-middle income clients live. CU has also found that some of these fringe lenders own finance companies in these areas. These lenders fill the gap where mainstream banks do not have a presence.

"Stronger usury laws and better access to mainstream banking services in low- and middle-income areas would curb abusive lending practices and make the Texas personal loan market more competitive in the future."

—Consumers Union

—by Dunya Bean, SRC

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Interim Senate Committee on Economic Development:
Subcommittee on Consumer Credit Laws

